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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

International Finance Series No. 21

The World Gold Market In 1969 And Prospects For 1970

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1970

INTELLIGENCE MEMORANDUM

The World Gold Market In 1969 And Prospects For 1970

Introduction

This memorandum, one of a series begun shortly after the two-tier gold market was established in March 1968, reviews and updates developments in both the official and private tiers of the world gold market through January 1970. Attention is focused on South Africa's gold marketing activities and on the December 1969 agreement modifying the two-tier system.

1969 Highlights

1. In 1969 the United States increased its monetary gold stocks for the first time in 12 years. A series of monetary crises forced several Western European countries to sell substantial amounts of gold, with the result that net US gold holdings rose by nearly $1 billion during the year. Late in the year the free market price for gold fell to and below the official price of $35 an ounce.

2. South Africa, beset with serious payments difficulties in 1969, sold gold worth an estimated $1,214 million* -- about $117 million more than production and nearly three times the 1968 level. Approximately 70% went to the free market, mostly

* *This and subsequent dollar amounts calculated at $35 per ounce.*

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

via channels of a Swiss consortium of three large Zurich banks -- the Union Bank of Switzerland, the Swiss Banking Corporation, and the Swiss Credit Bank. Official sales of about $345 million included $160 million disposed of in accordance with IMF regulations and approximately $185 million sold to monetary authorities in violation of the Washington Agreement of March 1968.

3. The precipitant fall in the free market price induced South Africa to negotiate an agreement modifying the two-tier system. South Africa may sell gold to the IMF under certain conditions, but agrees to try to sell most of its newly mined output on the free market. While the agreement essentially provides a floor price of $35 per ounce for South African gold, it guarantees a free market supply large enough to keep the free market price at or near the floor at least through 1970.

The Official Market for Gold

4. US monetary gold reserves gained almost $1 billion in 1969, reversing an unbroken pattern of year-to-year losses extending back to 1957. US sales to foreign central banks slightly exceeded $200 million, while purchases from monetary institutions totaled $1.17 billion. Nearly 60% of the US gold sales occurred in the first quarter, reflecting in part some uncertainty concerning the dollar. Most sales were small. Approximately 50 countries purchased US gold, but only five bought more than $10 million and these accounted for more than three-fourths of the outflow. US acquisitions, on the other hand, were large, with three countries -- France, Germany, and Spain -- supplying the major share. Early in the year, political uncertainties in France reinforced by a continuing lack of confidence in the French franc led to substantial capital outflows. The Bank of France, in supporting the franc, reduced its gold reserves by some $330 million, almost all of which augmented the US gold stock. Revaluation of the Deutschemark in September-October reversed a year-long trend which saw nearly $5 billion in short-term funds pour into Germany. The turnabout was rapid and massive. By December, to avoid a shortage of liquidity, the Bundesbank had to sell $500 million

of its gold to the United States.* Another large quantity was added to US stocks in December when Spain sold $200 million under a six-month forward contract to the Bank of International Settlements (BIS) and the BIS sold the same amount spot to the United States. This somewhat roundabout method of completing the transaction enabled Spain to acquire the foreign exchange immediatelv and also to report yearend gold reserves virtually unchanged.

South African Gold Sales in 1969

5. Faced with a record payments deficit, South Africa in 1969 sold its entire output of newly mined gold as well as some previously accumulated. Total sales of $1,214 million exceeded current production by about $117 million (see Table 1). While most of this gold entered the free market, about 30% was sold to monetary authorities.

6. Between early March** and the end of the year, South Africa sold some 770 tons of gold (or almost $870 million valued at $35 per ounce) to the free market via the Zurich consortium (see Table 2). 25X1 [redacted] 25X1 At least 63 confirmed and 10 probable consignments totaling 709 tons reached Zurich in this manner.

7. South Africa's foreign exchange receipts from free market sales may have exceeded $1 billion. The actual prices paid to South Africa are not known, but fragmentary evidence gathered from several European bullion dealers and gold market analysts suggests that South Africa received close to the

* *This liquidity crisis also forced the Germans to make a $540 million IMF drawing in November 1969 and a $550 million IMF drawing in December 1969 as well as to redeem $500 million in medium-term US Treasury obligations in January 1970. None of these transactions, however, involved any change in US gold stocks.*

** *There is no evidence of any free market sales in the first two months of 1969.*

Table 1

South African Gold Reserves
as of 2 January 1970 a/

	Million US $
Reported reserves (31 December 1968)	1,243
Production (January-October 1969)	908
Estimated production (1 November 1969 - 2 January 1970)	189
Estimated reserves before sales	2,340
Sales	
Official	345
Free market (confirmed)	698
Free market (probable)	101
Two sales in December to UBS of gold held in the Bank of England	70
Total sales	1,214
Estimated reserves after sales	1,126
Reported reserves (2 January 1970)	1,106
Difference held by Chamber of Mines	20

a. For consistency in analyzing reserve data, values are calculated at $35 per troy ounce.

free market price. Since premiums ranged from $7.50 per ounce in March, April, and May to $4 or $5 in late summer and fell to virtually nothing in December, this meant about $70 million in additional foreign exchange receipts over the $35 an ounce official price. At the end of the year, South Africa had earmarked another two million ounces ($70 million at $35 per ounce) for the Swiss. Although this gold was not shipped to Zurich in 1969, the Swiss probably credited South Africa's account in December. Another one million ounces were sold to the Swiss in early January.

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Table 2

South African Free Market Gold Sales
1969

Month	Metric Tons	Million US $ a/
March	56	63
April	66	74
May	45	51
June	57	64
July	61	69
August	74	83
September	74	83
October	82	92
November	84	95
December b/	172	194
Total	*771*	*868*

a. Based on the official price of $35 per ounce.
b. The December figures include 62 tons ($70 million) sold to the Zurich consortium from South African gold held in the Bank of England.

8. Official sales for the year totaled $345 million, of which $160 million was in accordance with IMF regulations and $185 million is believed to have been sold to official purchasers in violation of the Washington Agreement (see Table 3). In the latter category, both the Congo (Kinshasa) and Singapore violated the intent of the Washington Agreement by purchasing from South Africa $50 million and $23.6 million, respectively. The identity of the other official purchasers is unknown, except to their

Table 3

Official South African Gold Transactions
1969

Month	Purchaser	Million US $ a/	Metric Tons
January	Congo (Kinshasa)	10.0	8.9
February	Congo (Kinshasa)	10.0	8.9
March	Peru (IMF rand drawing)	6.0	5.3
April	None	--	--
May	Singapore	23.6	21.0
	Congo (Kinshasa)	10.0	8.9
June	Unidentified official purchaser through Union Bank of Switzerland	11.3	10.0
	Unidentified official purchaser through Commerce and Securities Bank	13.5	12.0
July	Unidentified official purchaser through Commerce and Securities Bank	13.5	12.0
	Unidentified official purchaser through Commerce and Securities Bank	13.5	12.0
	Congo (Kinshasa)	10.0	8.9
	Rand repurchase from IMF	50.0	44.4
August	Unidentified official purchaser through Commerce and Securities Bank	13.5	12.0
	Congo (Kinshasa)	10.0	8.9
September	Unidentified official purchaser through Commerce and Securities Bank	13.5	12.0
	Unidentified official purchaser through Commerce and Securities Bank	15.2	13.5
	France (IMF rand drawing)	24.0	21.3
	United Kingdom (IMF rand drawing)	10.0	8.9
October	None	--	--
November	Swiss Banking Corporation	17.5	15.6
	West Germany (IMF rand drawing)	25.0	22.2
December	West Germany (IMF rand drawing)	20.0	17.8
	United Kingdom (IMF rand drawing)	25.0	22.2
Total		*345.1*	*306.7*

a. Based on the official price of $35 per ounce.

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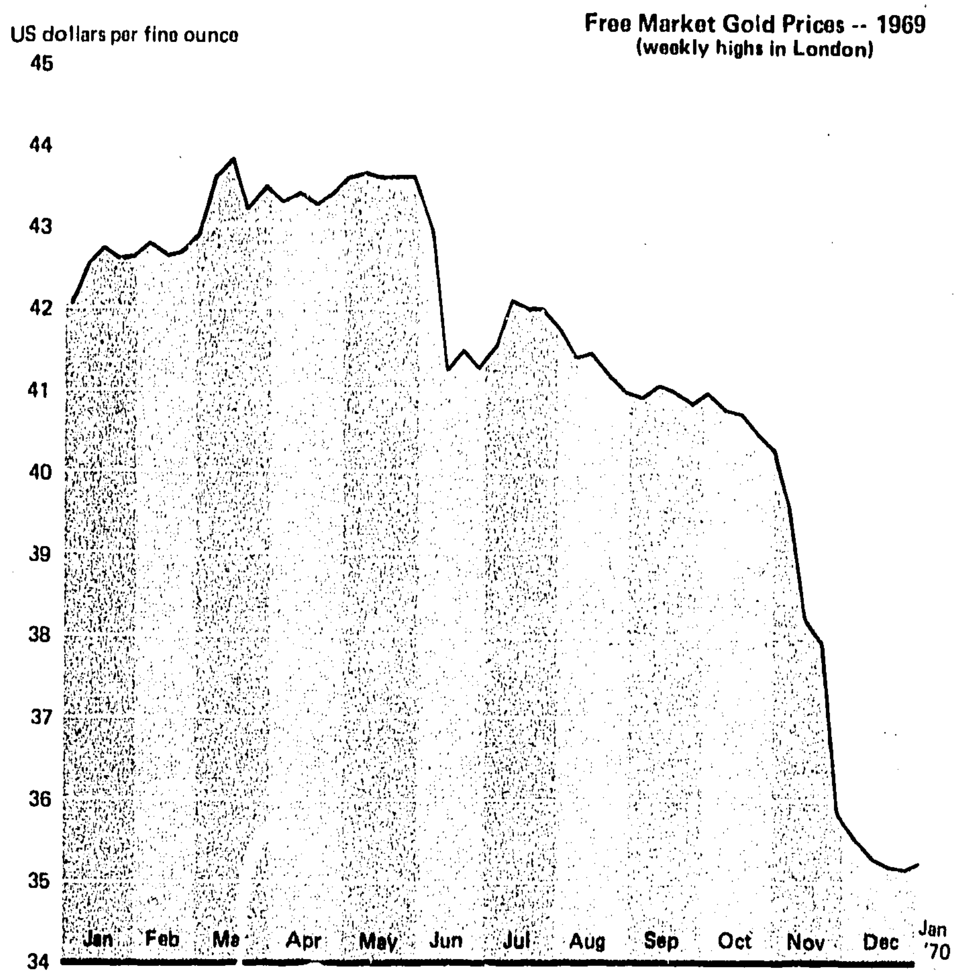
Zurich bankers. [redacted] 25X1

[redacted] Data submitted by South Africa placed their official sales $85 million below US calculations. It was asserted that sales to the Commerce and Securities Bank were not passed to official buyers. 25X1

The Free Market for Gold

9. Free market gold prices began the year at about $42 per ounce and rose to a daily high of $43.825 on 10 March before slipping to the $43 to $42 level during much of the second and third quarters. In late summer, prices again began an orderly retreat. By early December, however, the retreat developed into a full scale rout, with the London fixing actually set at $35 per ounce (see the chart).

10. The sharp decline in free market prices during the course of the year reflected an improved outlook for international monetary stability as well as the bearish views and actions of several European bullion dealers. The French franc devaluation and the Deutschemark revaluation plus the final approval of Special Drawing Rights (SDR's) at the September-October IMF meeting in Washington combined with high Eurodollar interest rates greatly reduced speculative demand for gold and precluded any substantial near-term price increase. Subsequently, the publication of bearish prognostications concerning the near-term outlook for gold by Samuel Montagu, Ltd. (London) and the Swiss Credit Bank (Zurich) further depressed free market prices. By this time the Swiss Credit Bank had sold virtually all its gold holdings on the free market. Moreover, word that progressively larger supplies of South African gold were reaching Switzerland spread through the principal markets.



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The December Agreement

11. As free market prices plummeted in November and early December, South Africa increasingly sought to avoid total dependence on capricious free market forces through an agreement which would give some regular access to the official tier. By late December, such an agreement had been reached.* South Africa gained the right to sell newly mined gold to the IMF under specified circumstances. In return, South African officials pledged to try to cover the country's foreign exchange needs through the orderly placement of the newly mined output on

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* *A handling charge of 0.25% reduces the actual amount received by South Africa to $34.9125.*

the private market, thereby greatly reducing the risk of price disparities which could jeopardize the two-tier system. The agreement, in effect, guarantees South Africa a floor price of $35 per ounce for its gold.* As always, South Africa can use its gold reserves to cover the gold portion of any of its own IMF quota increases, to redeem rand drawn by other Fund members, and for other normal transactions of the Fund. What is new is that the agreement also allows South Africa to sell to the IMF under the following conditions: (a) when the free market gold price falls to or below $35 per ounce and there is a deficit, as is almost always the case, in the South African balance of payments, excluding gold; (b) regardless of the free market price, when South Africa's deficit over a semiannual period exceeds the value of current gold production, whether sold on the free market or to the IMF; and (c) South Africa can also sell to the IMF up to $35 million each quarter from a pool of $253 million based on the stocks held on the date of the Washington Agreement of March 1968 as reduced by subsequent official sales, including the sale of $35 million to the IMF pursuant to the request made by South Africa in May 1968. The pool cannot be replenished and some of the other official sales are applied against this pool.

Outlook

12. A substantial South African balance-of-payments deficit is widely anticipated this year. The economy grew rapidly in 1969, with real GNP increasing at about 8%. Imports rose to record levels, while the unusually high net private capital inflow of the preceding two years was substantially reduced. Rapid domestic economic growth should continue in 1970. Private fixed investment, stimulated by high corporate savings, increasing income, and high rates of capacity utilization, is projected to increase almost 11%. Public fixed investment will rise even more rapidly, and GNP is expected to grow about 10%. To sustain the growth in income and to finance the projected accompanying deficit on current account, South Africa will need to sell approximately $1.5

* *For details on the December agreement, see the Appendix.*

billion in gold -- that is, all newly mined gold as well as more than $400 million from existing stocks.

13. In 1970, through the first week of February, South Africa sold approximately $200 million in gold, most of which went to the IMF under the provisions of the December Agreement. Of the remaining $1.3 billion needed to finance South Africa's foreign exchange requirements in 1970, $35 million will probably be sold from the "pool" during the first and second quarters of 1970, and approximately another $350 million will go to the IMF through normal Fund transactions and the operation of the semiannual deficit clause of the December Agreement, regardless of the free market price. This leaves a residual of not quite $900 million that would have to be sold on the free market in an orderly manner, providing the London free market price remained above $35 per ounce.

14. South African sales of $900 million would be almost equal to estimated world industrial demand for gold. Other Free World countries normally add up to $350 million in new output annually, all of which would have to be placed on the free market, thus substantially exceeding worldwide industrial demand. Given the recent improvement in the international monetary situation it is probable that 1970, in contrast to 1969, will be a relatively crisis-free year, that speculative and hoarding demand for gold will be considerably smaller than in recent years, and that many who speculated on gold in the past will want to reduce their holdings. In particular the Swiss consortium, which during late 1969 accumulated large inventories of South African gold, may be an important source of gold for the free market. The total supply of gold consequently will probably exceed demand at $35 an ounce, possibly by $200 million to $300 million, an amount that South Africa could sell to the IMF thereby reducing its free market sales in 1970 to between $600 million and $700 million.

APPENDIX

The December Agreement gives South Africa the right to sell gold to the IMF under the following conditions:

(a) To the extent of its current payments need, South Africa may sell up to one-fifth of one week's gold production (approximately $4.1 million) for each day the free market price is $35 per ounce or below at both the morning and afternoon London fixings. When invoked, this option must be exercised within a reasonable time.

(b) When there is a semiannual balance-of-payments deficit calculated after treating as exports the sales of all newly mined gold during the same period, South Africa may sell an additional amount of gold to the IMF equal to the remaining portion of the deficit. Because the size of the deficit may fluctuate significantly during any given six-month period, South Africa may sell gold to the IMF under this option on a daily or weekly basis. Any excess or shortfall in sales then will be applied to the succeeding accounting period. Moreover, any newly mined gold not needed to cover deficits may be added to reserves.

(c) South Africa may also sell up to $35 million each quarter from a nonrenewable "pool." The size of this "pool" equals the value of South African reserves on 17 March 1968 ($725 million) minus the sum of sales to monetary authorities (set at $437 million) between 17 March 1968 and 1 January 1970. All normal IMF-related sales -- for example, member rand drawings in exchange for gold, as well as sales under the deficit criteria (b), but excluding sales under the price criteria (a), must be applied against the "pool" until the entire $288 million is depleted. Given the normal level of rand drawings and an estimated South African deficit after sales of newly mined gold valued at $425 million in 1970, the "pool" probably will be exhausted by the fall of 1970.